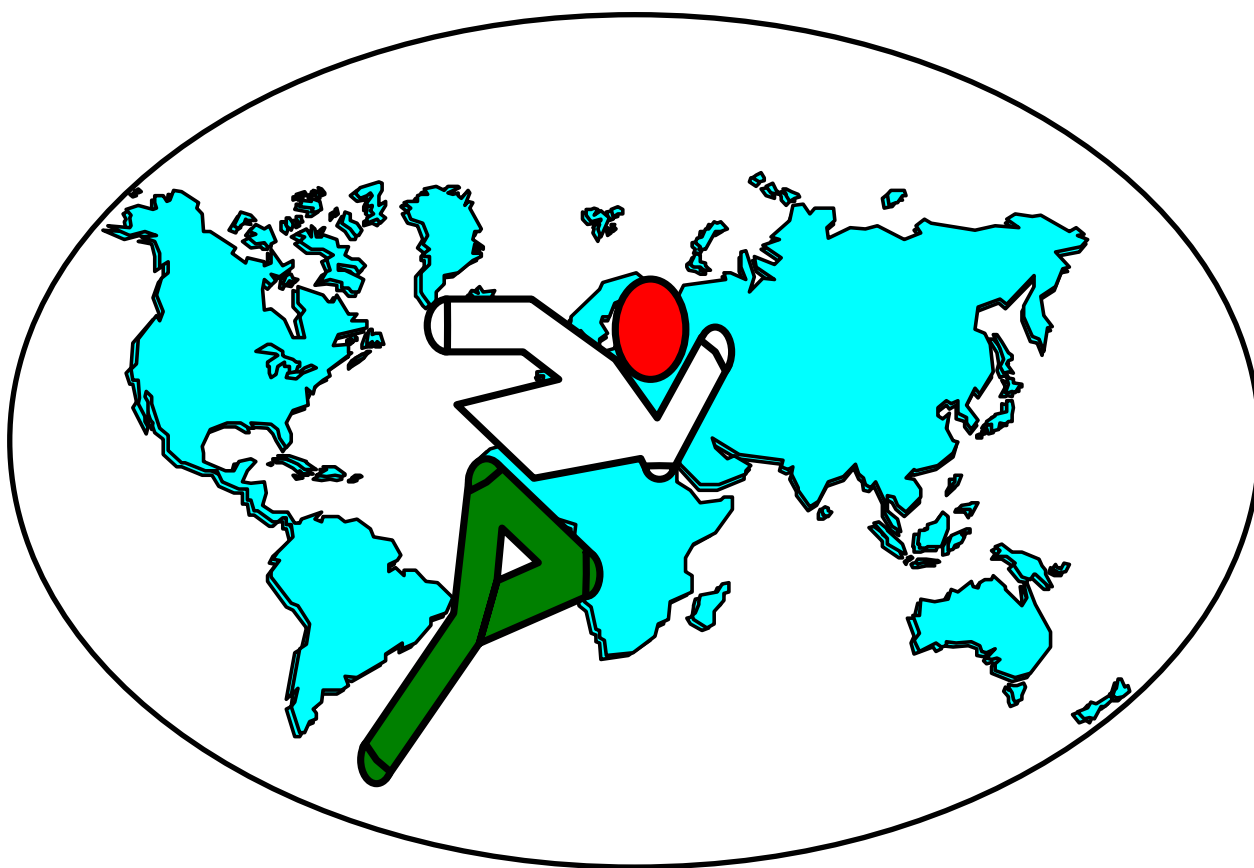


REPORT

**on competitiveness of the Hungarian enterprise
sphere**



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BUDAPEST UNIVERSITY OF ECONOMIC SCIENCES

Department of Business Economics

H-1053 Budapest, Veres Pálné u. 36. Tel./Fax: 118-3037

<http://www.bke.hu/tanszekek/vallgazd/hpangol.htm>

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Author: Professor Attila Chikán, Head of Department, Department of Business Economics, Budapest University of Economic Sciences, Director of the research program

The report is based on the following final project reports:

István Ábel et. al.: Financial Policies and Financial Markets

István Bartók: Economic Policy and Competitiveness

Attila Chikán: Interaction among Economic Actors

Tamás Csányi: The Role of Information in Competitiveness

Erzsébet Czákó: Competitiveness of Selected Hungarian Industries

Krisztina Demeter: Business Processes and Competitiveness

Miklós Dobák et. al.: Management and Competitiveness

László Zsolnai: Social Aspects of Competitiveness

The English version of this Report and the project final reports is forthcoming in „Economy and Society”, the English language periodical of the BUES

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Introduction

This Report summarizes the results of the analysis based on the work of close to 200 researchers and practitioners in the two-year program. Its aim is to give an overview of those conclusions which we consider most important for the practice of business and government's economic policy. The Report is not designed to provide the foundations of the theses - however we are more than happy to give out all the background material, which is enough to fill a small library.

The Report is of descriptive character: we did not try to make explicit suggestions here. Our objective was to publish an analysis of the current situation which is based on characteristic statements, clearly observable values but is free from any influence of everyday politics. We have formulated policy recommendations in a separate paper.

We have a differentiated picture of the competitiveness of the Hungarian enterprise sector in that we found both positive and negative characteristics. In general we would say that our enterprise sector has definite chances in the global competition, in the shadow of multinational giants (in some cases in their side-current). However, for their success difficult and comprehensive social, political and economic changes are necessary which embrace such remote areas as social security, economic values and managerial methodology.

Summary: Seven main theses

In this chapter a brief summary of the main conclusions is given. A detailed description of the conclusions is provided in the chapters which follow, while the empirical background and the arguments behind the conclusions are included in the papers prepared during the program.

1. The transition of the Hungarian enterprise sector has been basically completed; the behavior of enterprises shows the characteristics of a market economy. Obviously, this does not mean that still there will not be very important changes in the Hungarian economy, but the characteristics and operation of our economy cannot be explained referring to the transition any more. This is „our” market economy; further changes will go on in this framework.

The transition of the business sphere has been completed.

2. The performance of the now predominantly market-oriented enterprise sphere has significantly improved. However the speed of performance improvement is still lower than that of the most developed countries, so our handicap is increasing. At the same time, the distance from the countries which lag most behind is also increasing.

The performance of companies has improved substantially.

3. The legitimacy of the market economy is rather low. This leads to consequences which generally and to a great extent hinder the competitiveness of our economy. The black economy, the low tax paying morality, and the low level of business ethics increase the cost of the operation of the economy and increase the frictions and disturbances in economic processes. The negative social phenomena and the lack of legitimacy mutually reinforce each other.

The social legitimacy of the market economy is low.

4. The evaluation of economic policy of both governing party coalitions since the beginning of the transition gives a mixed picture: there were measures which helped and others which decreased competitiveness. According to the views expressed by company executives, economic policy had a mostly unfavorable effect on competitiveness. The improved performance of the microsphere is a result of the strength of the organizing power of the market and not a consequence of economic policy. Macroeconomic stability experienced in the last two years has been achieved at the expense of harder operating conditions of companies (which, on the other hand, helps improving competitiveness on the long

The improved performance is the consequence of the effects of market forces. Governmental economic policy was not very supportive.

run). Both governments share the responsibility for the low level of legitimacy of the market economy. On the other hand, the Hungarian way of privatization has had a rather strong positive effect on competitiveness.

The main obstacles of improving competitiveness are the weaknesses in innovation and education.

5. The two outstanding direct obstacles to improvement of competitiveness are the weakness of the innovation and education systems. In both fields much larger direct and indirect governmental assistance would be necessary but it has to be accounted that the attitude of executives is not always appropriate either.

Sectoral restructuring of the economy has been basically completed.

6. The structure of the Hungarian economy has fundamentally changed in the last few years, according to the needs of transformation to a market economy. The further development of the sectoral structure of the economy from now on will go on in an organic way, within the frame of the market economy. No major structural shocks can be expected in the future, even if Hungary joins the EU - the sectoral structure of the economy puts no problems on competitiveness.

Methodological knowledge and skills are very important differentiating factors among companies and their managers.

7. Today rather large differences can already be observed between companies and between executives and managers regarding managerial skills and professional competence. These differences, considering that the mobility of managers have also greatly increased, will be key factors in differentiating competitiveness among companies.

1. Objectives and structure of the research program

The research program was designed and planned at the very beginning of 1995. At that time the international judgment of the situation and perspectives of the Hungarian economy was rather unfavorable. Without going into details, we simply note that we were at that time still before the implementation of the stabilizing package of the government (the so-called „Bokros-package”, named after the then Minister of Finance), the macroeconomic indicators of our economy deteriorated and both the domestic and the foreign press were loaded with articles claiming that Hungary lost the advantages it had vis-a-vis other ex-socialist countries at the beginning of the transition.

1.1. Background of the research

Being researchers in close contact with companies and other actors of the microsphere, we could not accept the above evaluation. It was almost exclusively based on macroeconomic data, and we thought that there are far more positive developments and, favorable features in the microsphere than it appears looking only at macro data. The advantage of the Hungarian economy in the transition was exactly stemming from the fact that, as a consequence of pre-transition reforms and an earlier start, those structural changes which deteriorate macroindicators on the short run have been completed faster and in a more radical way than in other countries. These structural changes laid the foundations for further development and brought the end of the transition and the start of real market-oriented operation closer.

These days the macroeconomic indicators show improved performance. However, the issue of micro-level competitiveness is hotter than ever. The intention to join NATO and the European Union throws a sharp light on the need for structural fit of Hungary to the European and global economy. This fit may mean cooperation in one case, competition in the other - but in any case it requires that the actors of the economy follow the behavioral patterns of a market economy and that they can be partners

The initial hypothesis in 1995: there are far more positive developments in the microsphere than is reflected by aggregate macroeconomic data.

Today the issue of competitiveness is put forward by Hungary's intention to join the NATO and the EU.

Competitiveness: the ability to outperform competitors by quality, time and cost criteria.

also in effectivity. These requirements appear as factors of competitiveness: we can take part in the competition only by following the appropriate rules and we have a chance to be successful only applying them effectively.

Even though this was an empirically oriented program, we dealt also with the definition of competitiveness. We have an exact analysis of the concept which satisfies „scientific” criteria. The aim of this study does not seek to discuss various approaches found in the literature - we just briefly summarize that enterprise-level competitiveness is defined as a permanent adaptability: as a capability to monitor and understand changes in the environment and within the company and to adapt to these changes maintaining profitability. A competitive company is able to sustain a performance, meeting market requirements better than its competitors.

In the subtitle of the program the expression „factors of the microsphere” is mentioned. Our research concentrated from among these factors on those related to business enterprises, since we believe they are the key players. At some points we will refer to other institutions of the microsphere (like households, local governments, professional associations etc.).

1.2. Structure of the program

The scope of the program can be described on a two-dimensional plane. One dimension can be defined by the functions performed at each enterprise. For our analysis we considered three functions: production, finance, and the social function. It is easy to see that with an appropriate definition of the three functions we can cover all enterprise activities.

The other dimension of the analysis refers to the various levels related to the enterprise as an organization. So we can talk about

- Analysis of enterprise behavior: a holistic view
- Inter-enterprise relations; connections and networks of enterprises
- Enterprise structure (management and organization)
- Enterprise functions and operations.

The structure of the research can be described in a two dimensional matrix, determined by the above aspects. In the preparatory phase of the

research we analyzed the possible focuses of the program and defined eight projects, illustrated by the ellipses on Figure 1. The eight projects are the following:

1. Government's economic policy and competitiveness
2. Financial policies and financial markets
3. Competitiveness of sectors
4. Interaction among economic actors
5. Management and competitiveness
6. Business processes and competitiveness
7. The role of information in competitiveness
8. Social aspects of competitiveness.

Figure 1: The allocation of projects in the space of research issues

Structural dimensions	Functional dimensions		
	Production	Financial	Social
Company behaviour			

The methodology of the program included case research, statistical analysis, interviews and several surveys. One „central” survey must be advanced: in May-June 1996 we have completed a survey of 1300 executives of 325 companies. The figures of this Report come from this survey (with a few exceptions which will be referenced), of which a separate report was published under the title „Companies in (forced) march”.

During the whole program we managed to keep the planned schedule. The organizational chart of the program, some characteristic data, and the list of Advisory Board members are given in Appendices. The main sponsor of the program was the CIPE (Center for International Private Enterprise, Washington DC) which financed close to half of the budget with funds from USAID. Hereby we express our gratitude to all our sponsors (their list is on the inside back cover).

2. On global competition

Before describing the current Hungarian situation a very brief draft on our view of the global competition is given to show how we see the environment in which the competitiveness of Hungarian enterprises is tested.

According to our view there are four main tendencies in the world economy at the turn of the millennium:

1. **Globalization** means that legal and operational boundaries of enterprises cross the national borders; that companies think in terms of the whole world economy when deciding about their activity, their customers, and their allocation of resources; and that the processes they generate create a global network.

2. **Integration** is a general phenomenon on all levels of the economy, from internal operation of enterprises to regional cooperation. Its main rationality is to minimize disturbances in the processes of production and distribution of goods, diminish circumstances the free flow of goods, information, labor and money. One of the consequences of integration is today that competition goes on more between networks of companies (strategic alliances, supply chains) than among individual companies.

3. **Humanization**, is a consequence of the increased importance of the labor force and of human knowledge, and leads to focusing on the human aspect of both the processes and the results of economic activity and on the increased stress on human and ecological environment.

4. **Customer focus** is the result of increased competition in which only those companies survive which are able to fulfill the growing demand of customers for quality and variety in a fast and flexible manner.

All of the above factors are in close connection with competitiveness and led to the increase of its importance. The analysis of various levels of competitiveness, most notably on the level of products, companies, sectors and economies, gained a lot of ground recently.

Main tendencies of economic development: globalization, integration, humanization, and customer focus.

An OECD report provides a list of macroeconomic factors of competitiveness, based on data from eleven countries.

An OECD study based on eleven country reports summarizes the main macroeconomic and policy factors of national competitiveness. The following factors were considered fundamental in each of the eleven reports:

- macroeconomic stability;
- favorable environment for doing business;
- improvement of labor and labor market conditions (employment, living standard etc.);
- education and training.

Other most frequently mentioned factors were

- innovation and R+D;
- stimulation of investments;
- assistance to small and medium size enterprises;
- development of physical and information infrastructure;
- development of corporate governance;
- refinement and adjustment of corporate income tax system;
- development of export potentials.

One of the leading scholars in international competitiveness is Michael Porter, a professor of Harvard Business School, who considers four phases of international (global) competitiveness:

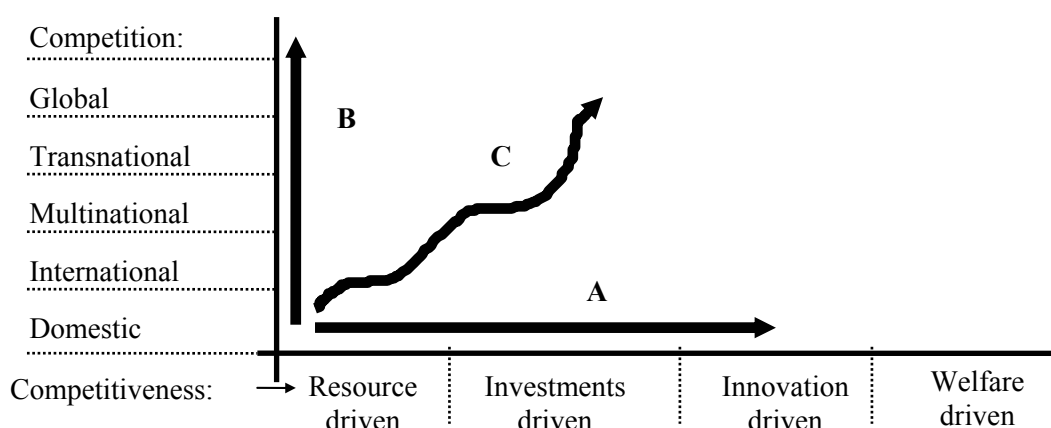
***Four phases of competitiveness:
resource-driven,
investment-driven,
innovation-driven and
welfare-driven competitiveness.***

- **resource-driven**, when the basis of competitiveness is the availability of some economic resources (like natural resources, inexpensive labor or geographic position);
- **investment-driven**, when both domestic and foreign investors consider a country favorable for investments; the technical level of new productive investments is high and new capacities are well utilized;
- **innovation-driven**, when the higher and higher customer demand is fulfilled more and more with products and technologies of own development;
- **welfare-driven**, when the engine of development is the social welfare achieved - which can lead to the decline of competitiveness if no appropriate measures are taken.

In a paper presented at an international conference organized by our research program, Ferenc Vissi, President of Hungary's Economic Competition Office, combined the above four phases of competitiveness with the modes of taking part in international economic activity and found three main lines of development as seen in Figure 2. He stated that the Hungarian economy has developed in the last few years along line B, which means that the majority of the Hungarian economic sectors (and within that, companies) enters international competition at the lowest phase. The years of political and economic transition have created circumstances which have suddenly „thrown out” the Hungarian economy from its previous state into global competition, without allowing time to enter a higher phase of competitiveness.

The integration of the Hungarian economy into world competition follows mainly the B line on Figure 2.

Figure 2: Competitiveness pathes



According to several judgments, however, the transition economies, including Hungary, can continue this development within certain limits - successful participation in global competition needs at least some sectors competing according to the characteristics of higher phases, i.e. on investment or innovation-driven way. Hungary has moved in the last couple of years towards the investment-driven way of competition, while only minor elements of the innovation-driven way can be found. We believe that considering the status and characteristics of the Hungarian economy, it can enter into this phase to the extent that Hungarian companies can become part of multinational and global networks of companies, since these

networks play the key role in determining the factors and conditions of competitiveness. Of course, the national environment can help or hinder achieving a higher level of competitiveness.

Parallel with the escalation of global competition we can see a number of signs (and warnings) of the dangers of expansion of competition. Several studies reflect the crisis of values connected to competition and its consequences, in the sphere of economic policy, corporate governance and popular opinion. This is a global crisis which is reflected also in the conditions of Hungary. Some of the issues need special handling while we had and perhaps still have some degree of freedom in forming the new political and social order. This value crisis is probably an important reason of the contradiction (mentioned among the main conclusion of the research program) that the company sphere's successes in increasing competitiveness happened to a great extent not because of a supportive economic policy, but sometimes despite difficulties created by that policy.

3. Conclusions of the program

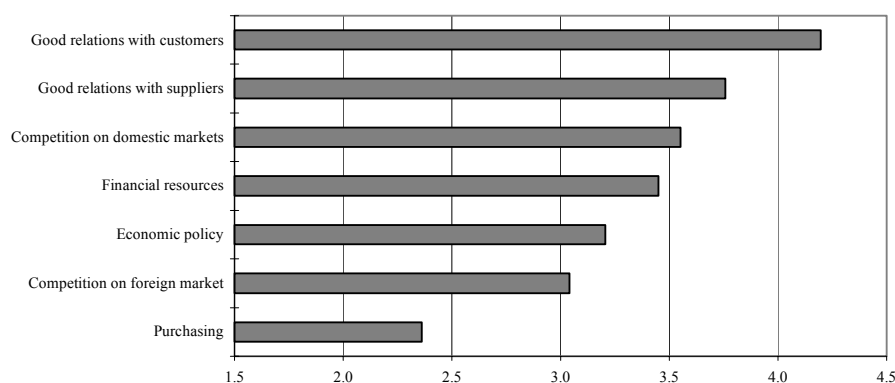
In this section the conclusions of the program will be described. First the situation of the enterprise sphere in Hungary will be characterized, then we continue with the general analysis of its competitiveness in three sections. The first deals with the social background, the second with economic policy impacts, and the third turns to the operation of enterprises.

3.1. Over the shortage economy

(1) The analysis of enterprise behavior shows that the activity of Hungarian enterprises can already be described with the characteristics of a market economy. In this sphere the transition has been completed. This, of course, does not mean that there will not be further changes (or that there is no need for further changes). However, these changes will go on within the framework of a market economy. It would lead to serious mistakes both in economic policy and in enterprise strategy if we did not realize that the challenges we face now are not consequences of the transition (and therefore will not disappear „when the transition is completed”) but that they have a root (perhaps going as deep as centuries of history) in the Hungarian reality. We must see that this is „our” market economy, which has to be operated as effectively as possible. Many changes are necessary but these, if carried out, will happen within the market system.

The operation of Hungarian companies shows the characteristics of a market economy.

Figure 3: The ranking of the main environmental factors influencing operation shows an almost completely opposite order compared to the ranking in a shortage economy



Averages of weights given by respondents (1-5)

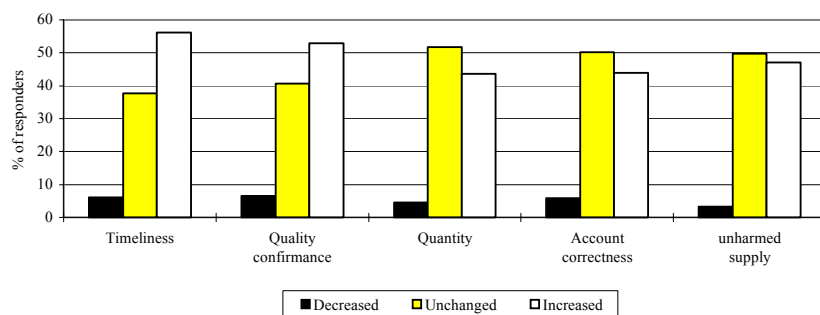
**The social transition
is a long lasting
process.**

**Companies'
performance has
improved but
improvement is
slower than in the
most developed
countries.**

(2) The dominance of the market economy's characteristics in the enterprise sphere does not mean that the transition of the Hungarian society has been completed. From among all spheres of the Hungarian society the enterprise sphere has reacted fastest to the changing requirements - mainly because, naturally, this is the sphere where the interest structure characteristic to the „new” system has had the most direct effects.

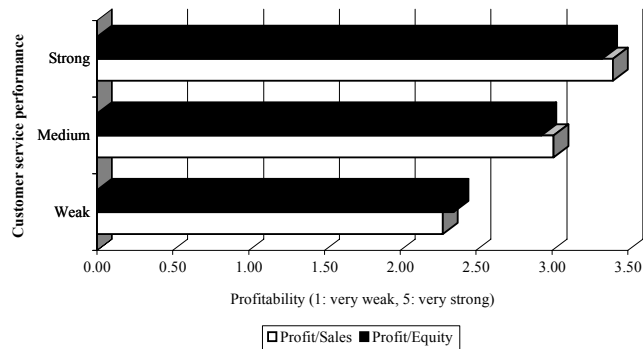
(3) The market characteristics have fundamentally changed, from the sellers' market to the buyers' market characteristics. This is, through the greatly increased customer orientation, the main reason behind the substantially increased market performance of companies. Cost and price sensitivity increased, and the extension of production is not constrained any more by the availability of resources but by the limits set by customer demand. Power relations on the market have changed in favor of customers; the general overdemand resembles the characteristics of market economies.

Figure 4: Customer service has substantially improved since 1992 (in % of companies responding)



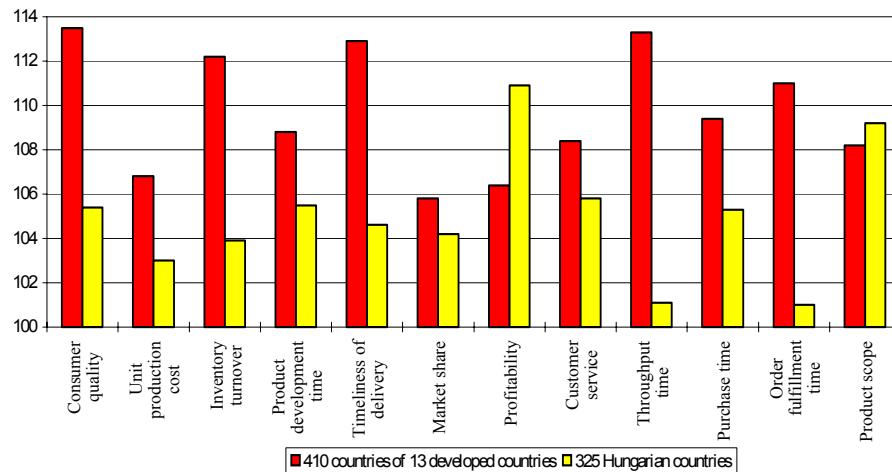
(4) The improved performance is honored by the market and since improvement is not equal at all companies, an increasing differentiation of companies is experienced. Companies had rather different initial conditions at the beginning of the transition; however, for today the differentiating factors have become independent of those conditions. The main success criteria are customer service, flexibility, reliability and quality. The chances of making extraordinary profit because of the transition conditions are over, both in the legal and (fortunately) in the illegal spheres.

Figure 5: There is a strong correlation between customer service performance and profitability



(5) Despite substantial development, the rate of improvement at the Hungarian companies is lagging behind that of the companies in the leading economies. This means that only those Hungarian companies which perform well above the average Hungarian level can be successful in global competition.

Figure 6: Production and logistics performance of companies in the most developed countries has improved faster than in Hungary



3.2. Social environment

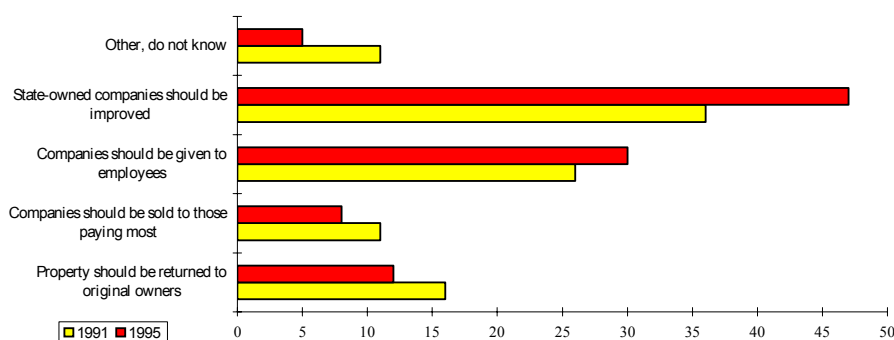
(1) On the eve of transition the ruling public opinion considered the transformation to a market economy very desirable: the liberalization of the market was supported, and there was a consensus in stopping uneconomical production and closing nonprofitable factories; the inflow of foreign capital

The social acceptance of the market economy has been seriously deteriorating since the beginning of the transition.

was welcome etc. This situation has gradually changed, for today the general attitude favors the limitation of market.

While market-oriented operation had public support at least at the beginning of the transition, the attitude towards privatization was ambivalent from the very beginning. Small property holding was accepted, but there was a strong negative feeling against the private ownership of large companies. From among the forms of privatization employee ownership programs were followed with sympathy, but auction-type privatization, when the property was sold for those who promised more, was opposed. The support of inflow of foreign capital has gradually deteriorated.

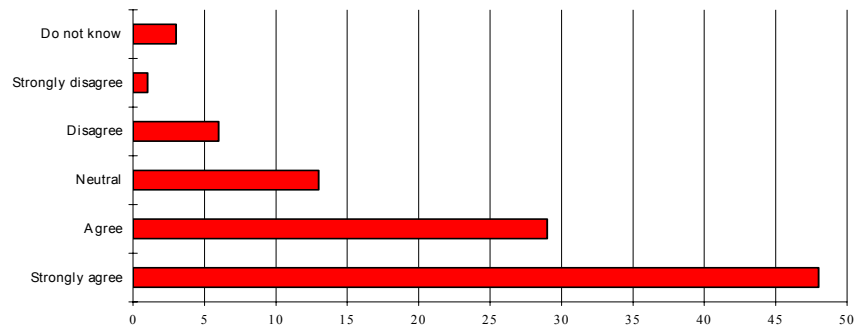
Figure 7: The social support of privatization is rather low (TÁRKI survey)



(2) The idea of maintaining (or, better to say, restating) social security is very attractive for most of the population, while the increase of income differentiation is followed with very negative feeling. Even those who support the market economy in general still expect the government to take responsibility to diminish social differences.

Figure 8: Most people agree that fighting poverty is the number one task (TÁRKI, 1993)

(3) Research studies, of course, do not find the Hungarian society homogeneous. It seems that five main types of attitudes towards the market economy can be



revealed: About one seventh of the population can be considered core supporters of the market economy and about 40% are definitely anti-capitalist, against the spread of private property. Accordingly, close to half of the population has double feelings towards the transition.

(4) Based on the above it is clear that the legitimacy of economic and social transition of the country is at a low level. This attitude slows down the development of competitiveness. We believe that there is no mystery behind this phenomenon: the reasons for that attitude can we found partly in historical experiences and traditions, partly in the developments during the transition. The latter group of reasons came partly as an objective consequence of the transition (the increase of social uncertainties was unavoidable, maybe the extent can be questioned), partly followed political mistakes and scandals which deteriorated public atmosphere.

The low level of social acceptance of the market economy has a strong negative impact on competitiveness.

(5) The low level of legitimacy of the market economy leads directly to the acceptance or at least „understanding” of features like black economy, low tax-paying morale and bad mood of the population which in turn deteriorate legitimacy. This vicious circle is, according to our view, one of the most important problems hindering competitiveness and integration of the Hungarian economy.

(6) In direct connection with the above phenomena the picture about business ethics and corporate culture is mixed. Institutions supporting ethical business behavior at the company level are in formation, about 10% of the companies have their own ethical codes. Those companies which operate on the markets of the most developed countries consider ethical behavior more important. At the same time our research does not suggest that foreign companies operating on the Hungarian market would be at a

There is a mixed picture of business ethics.

***Regional
differentiation in the
country is reflected
also in
competitiveness.***

higher ethical level than the average Hungarian companies. Environmental friendliness, mostly because of the relatively low environmental consciousness of the population, still does not provide a competitive edge, though it is an accepted norm by Hungarian companies on the international markets.

(7) We could analyse the regional aspects of competitiveness based on extensive surveys. The importance of regional aspects is increasing in competitiveness. In many respects international competition goes on between regions rather than countries, especially within the European Union. Regional analyses give much the same results in each field: Budapest and its agglomeration plus the (mostly North-) Western part of the country are in better shape and position. It is important to see that those companies which produce mostly for domestic markets are concentrated in the less developed area, so the various regions take part in international competition to a very different extent. There are good chances according to our data for the catch-up of the South-Transdanubian and South-Eastern region; as it is known, the North-Eastern region is in the most difficult situation.

(8) The shortcomings of the Hungarian economic information system became very apparent during the transition. This is partly the objective consequence of the fast changes, partly the result of subjective reasons. There are no credible data about most microeconomic processes. This increases the risk of economic activity, and makes handling uncertainties more expensive, which substantially decreases competitiveness. Since the maintenance of information shortage is a source of profit for many, there is a conflict of interests here, so a fast change in the situation cannot be expected.

(9) An important aspect of social embeddedness of companies is their relation to local governments. An extended research on that area revealed that local governments, as a rule, have appropriate means to influence local business and development, including their relationship with companies operating in their territory. Local governments maintain important servicing and organizing functions besides their public policy role. Their competition for private investments is an important factor in forming favourable general conditions for investments in the country.

(10) The orientation of the Hungarian public education system is not favourable for competitiveness. Our education is based on the transfer of cognitive knowledge. Factors developing successful business sense: success orientation, entrepreneurship, judgment of risk (effects of failure), compromise-seeking, conflict-handling, empathy, self-reliance etc. - are deficient in Hungarian socialization.

Orientation given by the education system is not favourable for becoming a successful economic actor.

The general lack of resources experienced in the Hungarian education system, reinforced by the governmental policy, is a great obstacle to development of the country.

Investments in education are at a low level.

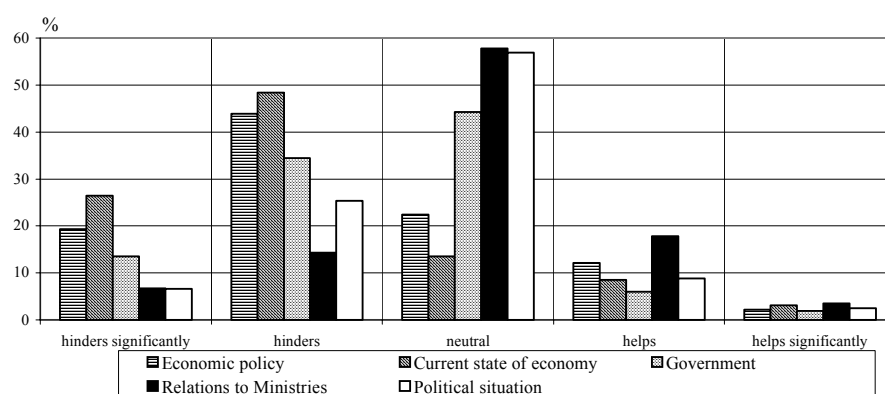
3.3. Economic policy

(1) Our research indicates that the completion of the transition and the relatively good performance of the Hungarian economy should be attributed more to the strength of the mechanisms of the market economy than to the active contribution of economic policy.

We still miss a clear economic policy concept for the long term development of the market economy.

Since the beginning of the transition we had two coalitions in government; they each had measures and steps both for and against competitiveness. On balance, according to the opinion of executives, economic policy (and its institutions) have had more negative than positive effect on competitiveness.

Figure 9: Government's economic policy and practice have negative effects on competitiveness



(2) If we consider those areas of economic policy which are in closest connection with competitiveness, we have to mention privatization, as a core area of the transition. It is also an economic success story: it is clear that in the process of privatization, which resulted in „real owners”,

Privatization, with all the problems it had, have contributed positively to the development of competitiveness.

the foundations of the long-term structural changes have been laid. From here, ownership structure can change on a generic way. This is true despite the faults, losses and ethical problems which occurred along the way.

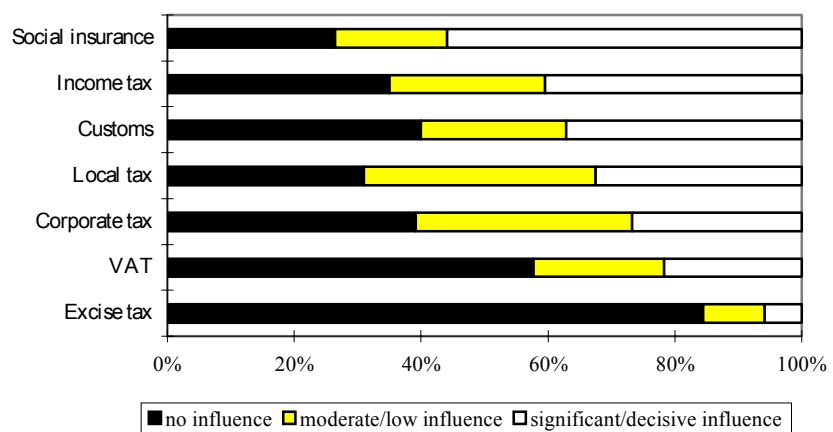
Privatization (due to a great extent but not exclusively to the inflow of foreign capital) had a very positive effect on competitiveness.

(3) The stability of macroeconomic processes is another important factor of competitiveness. The government's role in stabilization has been successful since the Bokros-package (named after the that-time Minister of Finance in 1995) and it has improved competitiveness of Hungarian companies.

(4) The taxation system, the high rate and changing nature of the redistribution of incomes, has a grave negative effect on competitiveness. We did not study the reasons behind the application of this systems in the framework of this project, but it is at least questionable whether it is necessary to maintain such a high level of redistribution. We accept that there is a politically rational basis for the high level of centralization of incomes (especially considering the findings about the social acceptance of the market economy), we still believe that here the appropriate proportions are not kept.

The high rate of redistribution of GDP is not sustainable.

Figure 10: Exportability is strongly influenced by taxes



(5) As for the competition policy, it corresponds to the expectations towards an efficiency-oriented competition policy and as such, it helps

competitiveness. The handling of natural monopolies and the effectiveness of their regulation is questionable.

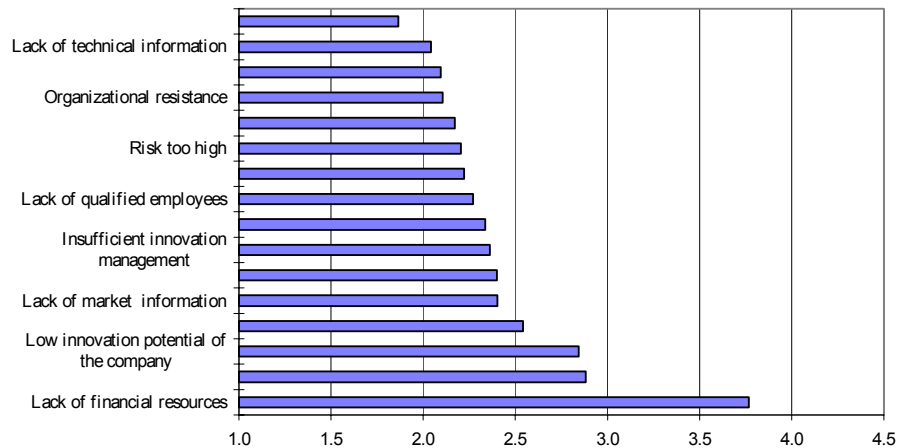
(6) The main task of the Hungarian economic policy in the next few years will be the preparation of the country to joining the EU. In this course we have to make steps forward regarding growth, inflation and budget balance. Further than that we have to correspond to several (explicit and latent) expectations about competitiveness of our enterprise sphere as well. The general effectiveness of our economy has increased substantially in the last few years, however it is still much lower than that of the developed countries. It is highly doubtful whether the low rate of wages really means a competitive edge on the long run. The role of agriculture and its place in economic policy is also questionable.

(7) Having analyzed the results of our research, we consider the government's policy towards innovation and education as most inappropriate. While all international experience shows that already in the medium term (in connection with Hungary's plan to join the European Union) these are the two most important factors of competitiveness, both seem to be disfavored from the point of view of government support. It is worth attention that the World Competitiveness Yearbook, which has a substantial influence on the international professional judgment of the various countries, reports that the picture in these two spheres is becoming dramatic (though the report can be criticized on good ground, its influence is indisputable). Investments and budgets are low in both spheres, salaries are insufficient, and there is a danger of exodus of the most qualified intelligence from the country. If we had to assess Hungarian development based on these two spheres, the result would be disastrous.

Joining the EU involves rather specific requirements about competitiveness. Most of them are already clear.

Government's economic policy is greatly responsible for the problems in innovation and education.

Figure 11: The most fundamental reasons obstructing innovation: lack of financial resources and high taxes



(8) In the last few years there were a lot of words (mostly complaints) about import liberalization, the actual extent of which according to many sources substantially reduced the competitiveness of Hungarian companies. It is hard to tell a straight opinion on this issue. We believe that the wide-range liberalization has helped more than it harmed. In some cases perhaps the government could have been more determined about specific market protection measures, but the maintenance of liberalized import has a positive effect on competitiveness.

Foreign direct investments had a substantial positive effect on the international integration and competitiveness of the economy.

(9) Foreign direct investments is one of the success stories of the Hungarian economy. Under the conditions of very scarce investable capital and a privatization policy which was looking for „real” owners, FDI necessarily played a crucial role in privatization. The overall evaluation of this role is unanimously positive, despite several problems in the process. The current ownership structure has a lot of advantages from the point of view of competitiveness. Some of the effects are direct: the presence of the large multinationals and the smaller joint ventures helps our integration, and contributes our preparedness in technology and management. Also, the multiplier effects are important: they force the partner’s improvement of performance, provide example (even though not to the extent sometimes believed), and transfer specific know-how to domestic companies.

These altogether led to the fundamental importance of FDI in competitiveness even on the long run (just like in other, more developed countries). No doubt, there are also risk effects, and not all foreign

investor/partners live up to the expectations, but this does not alter the overall picture.

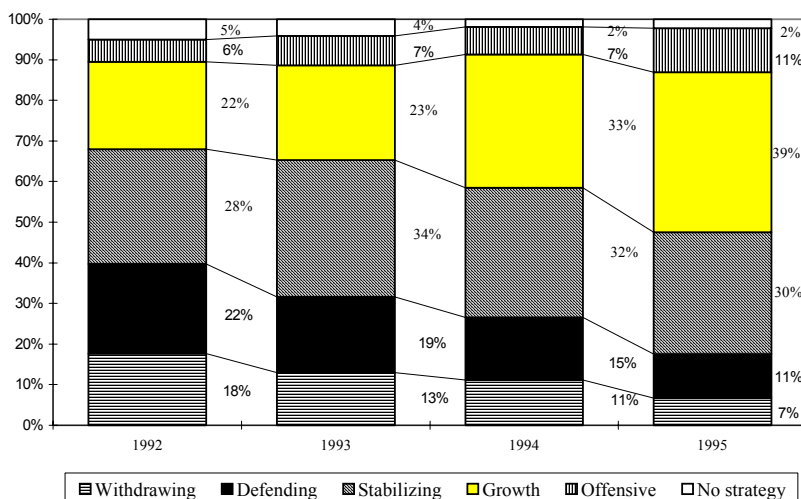
3.4. Strategy, management, operations

3.4.1. Strategy, management, operations

(1) There were very basic changes in the strategy and strategic behavior of Hungarian companies in the last few years and these changes were mostly favourable from the point of view of competitiveness. There was a substantial increase in the proportion of those companies which followed an active (offensive or growth-oriented) strategy against those with a passive (defensive or withdrawing) strategy.

Active, dynamic company strategies gain ground.

Figure 12: Company strategies have moved toward more active types between 1992 and 1995



However, the consciously followed strategic behavior has not become general yet. More and more Hungarian managers, having gone through privatization and the bumps of transition, feel the necessity of formalizing their mission and strategy; however many of them do not see yet a close connection between following a meaningful strategy and competitiveness. Lobbying the government still plays a greater role than in the developed countries; it is interesting to see that foreign companies are no exception in this behavior.

The new management elite is very much structured, mostly by attitude to political activity and by methodological skills.

It is a favorable development that there is a sharp upswing in the variety of strategies, and in connection with that, the variety of

organizational forms. True, however, that according to our research, organizational development depends in many cases on subjective factors rather than on planned organization design.

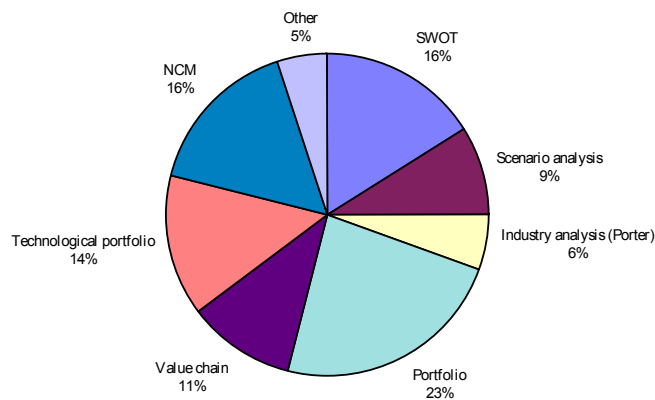
(2) As for management, it is of critical importance that rather early in the transition a sufficiently large group of managers have developed, the crème of which was not only able to adapt to the new requirements, but it became the engine of economic restructuring, and even further, of the development of civil society. This group is very much structured, mainly along two dimensions: the attitude towards roles in politics and professional qualifications. The internal structuring of the managers' group had for some time a negative effect on close inter-company cooperation and integrated relations, but this is over now.

(3) As for the management approaches to methodologies, two developments must be mentioned. First is the fast spread of the controlling function, which now operates well and is of key importance at most companies (even if in many cases with some methodological problems - but certainly building on international standards). As for management decision techniques, most companies are several years behind their Western European colleagues; and the role of personality of the decision maker is too large.

***The prestige of
methodological
education is rather
low.***

(4) The picture is mixed about the use of up-to-date management skills and knowledge. Foreign investors usually brought along management culture and methods, and their companies in Hungary had to follow this imported approach (for good or bad). At these companies the learning process was fast but one-sided. At domestic companies the situation is very differentiated: from world-class to much under-informed management, anything can be observed. In general we believe that a substantial proportion of the managers still does not understand the real importance of continuous education and reeducation. We forecast that the professional level of management will be one of the most important differentiating factors among companies in the next decade.

Figure 13: The use of up-to-date strategic planning methods is sporadic: methods used frequently (in % of respondents)



3.4.2. Inter-company relations, sectoral characteristics

(5) The analysis of the relationship structure among companies show that the organizing forces of the Hungarian economy are those characteristic to market economies. Our analysis does not support the view that in the cross-ownership of companies the pre-transition relations would survive. In the owner and capital searching strategy of companies there is a great variety, which reflects adaptability of companies.

(6) External investments (in other companies) have a modest effect on strengthening inter-company relations. However, in the coming years we may expect a fast increase of these investments; those barriers which prevented companies in making such investments have been mostly removed. A special and relatively new feature is the increase of investments of Hungarian companies in foreign, in many cases Eastern European markets. The weight of this latter investment relations is still modest, but is an important direction of future development. In the Eastern markets the relatively much larger experience of Hungarian companies can be utilized. However these markets are still rather risky.

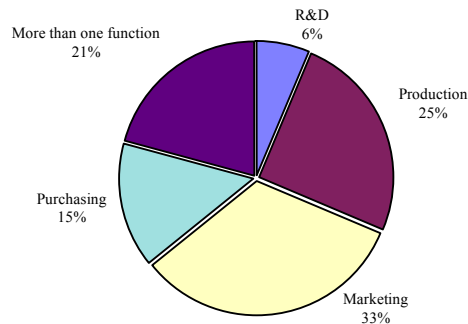
(7) As for long-term cooperation and strategic alliances, we have found that they can be observed only at a relatively small number of companies, but their spreading is fast. Interestingly, strategic alliances are mostly established among companies which would have been strong even without these alliances. Therefore, it cannot be said whether the

Foreign investments of Hungarian companies are getting more and more substantial.

The strength of the inter-company net is less than in the most developed countries.

performance indices of companies in strategic alliances are better because of their own strength or because of their participation in the strategic alliance.

Figure 14: Areas of cooperation in % of companies involved in strategic alliances



(8) In the developed countries, chambers of commerce and professional and sectoral associations play a key role in strengthening inter-company networks. We have found that even though these organizations have developed a lot since the beginning of the transition, their role in increasing competitiveness is still not substantial.

The majority of sectors in the Hungarian economy is going international on the grounds of resource - based competitiveness.

(9) We have completed structured studies in ten industries: pharmaceuticals, plastics, aluminium, iron and steel, poultry, milk, fruit and vegetable, motor vehicles, tourism and textile. From among these the pharmaceutical industry is the only one which has globalized itself as an „innovation-based” sector (as defined in the introduction). It adapted very successfully, increasing its competitiveness. Vehicle assembling and parts production has developed very fast, mainly on an investment-based way, following large investments by multinationals. This industry, as it can be expected, has had a very positive effect on the economy as a whole, but it is still a question how far this effect spreads and whether this sector will not form an isolated circle. Iron and steel, aluminium, plastics and textile are trading internationally on a „resource based” way. The integration of these sectors into the global economy is a fact, but this does not mean a stable position. The fruit and vegetable and the poultry industry are strongly export-oriented, but we cannot talk about their globalization. The milk industry has shown a dynamic growth, but it is not export-oriented. The only service industry examined, tourism, has a good perspective, however with a lot of uncertainties.

The details of the sector studies cannot be discussed here. The general picture is that the international integration of the sectors analyzed has developed substantially, on the basis of which we forecast that there will be no further cataclysms in the sectoral structure in Hungary, even in the case of our joining the EU. Obviously, this does not mean that there is no need for important adaptive steps, but we may say that the sectoral framework of the operation of Hungarian companies is as stable as such things can be, and that Hungarian companies must find their competitive advantage under these conditions.

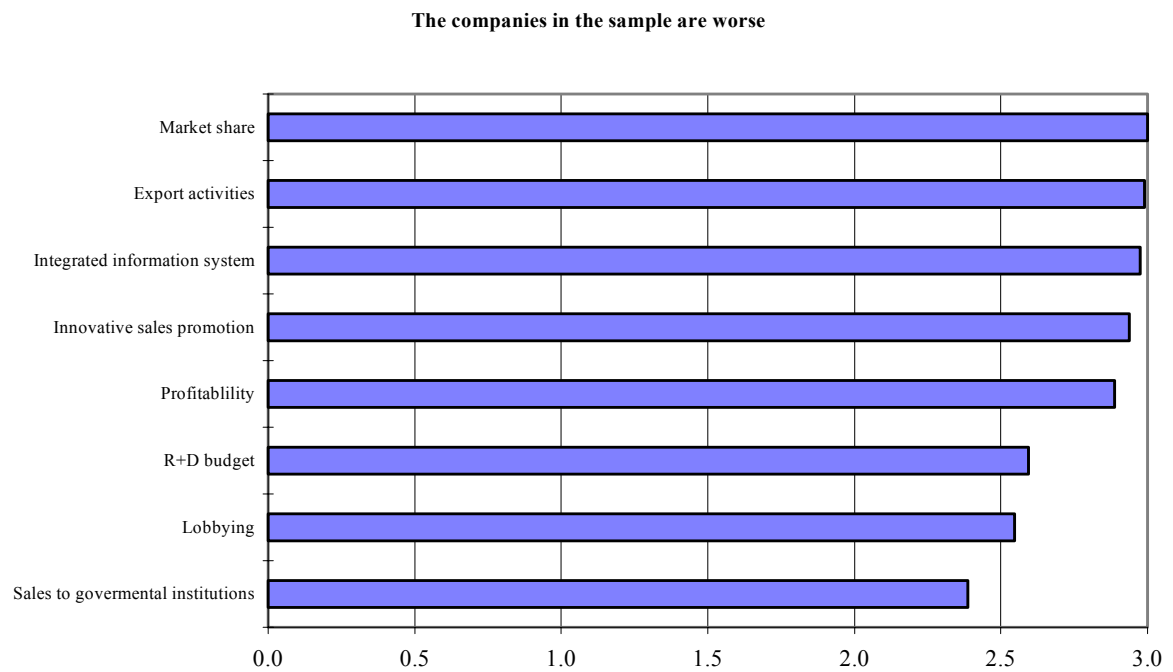
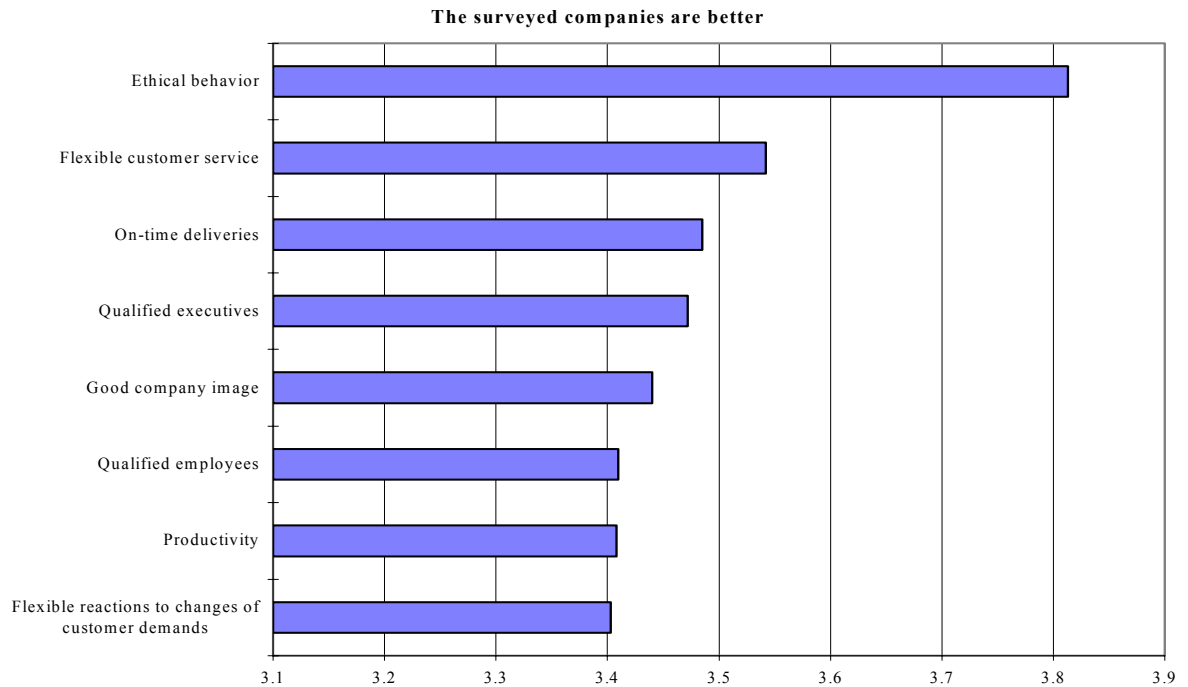
(10) A special project dealt with the operation and competitiveness of the banking sector. The institutional changes at the end of the eighties were followed with an increased market competition, which has rocked the bank system. After the low point in 1993 a recovery has started: under the conditions of sharp competition and strict government monetary policy our banks have increased their efficiency and effectivity and in the gradually improving macroeconomic environment they have also started to reduce interest rate. During the restructuring the Hungarian banking system has adapted to the competitive environment, even though at the price of severe losses.

No further cataclysms should be expected in the changes of sectorial structure.

3.4.3. Business activity, enterprise operation

(11) As it has already been discussed, the operation of Hungarian companies can already be described by the characteristics of a market economy. At the vast majority of companies business activity has been reorganized according to a market-oriented logic, which moved to the improvement of market performance. It is worth mentioning that, according to our investigations, foreign and jointly owned companies do not show a generally better performance, except the top, leading companies. The favorable picture about foreign companies and their outstanding performance has been formed on the basis of a few well-known (mostly multinational) companies. It is a matter of fact, however, that these leading companies have played an important pulling effect on the performance of a number of Hungarian companies (both partners and competitors).

Figure 15: Performance compared to main competitors



(12) The various functional areas within the company (marketing, finance, production etc.) have developed unequally - this is a key reason why those strategies and methodologies which build on the integration of these functions could not be implemented in a wide range of companies. Also, the level of integration of information systems is low at most companies. As a positive development we experienced that the occurrence of sophisticated managerial information systems is relatively frequent.

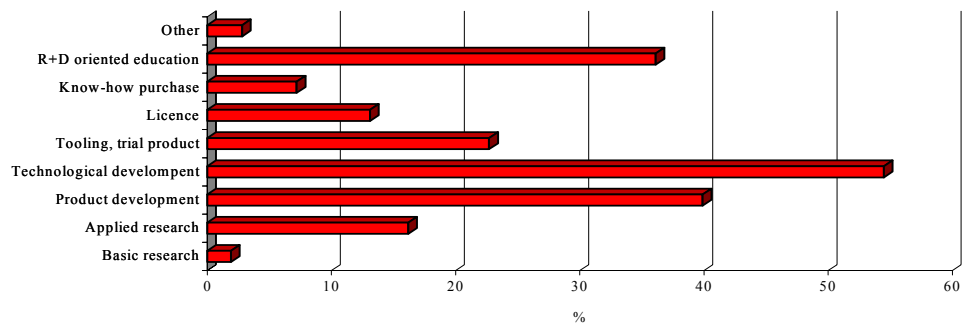
The internal integration of operational functions is rather low.

(13) The functions most effectively supporting competitiveness (according to the view of Hungarian managers) are human resource management, controlling, information management, quality management and logistics - which means that Hungarian managers see the connection between integrated operation and competitiveness (since these functions play key role in integration), even though they, as described in (12), still do not operate that way. This is promising for the future.

(14) All analyses consider innovation as a main carrier of competitiveness, so it is quite disappointing that R+D activity is rather underdeveloped at most Hungarian companies, concerning both R+D spending and organizational background. This is the functional area where Hungarian companies feel most handicapped compared to their competitors. Rather unfortunately not all managers weigh innovation properly from the point of view of competitiveness - these people do a lot of harm to their companies by muddling through day by day, trying to ensure survival this way. Naturally this is not only a question of views - scarce financial resources are a key issue. However, the majority of managers fully understand that no strategy without proper innovation can lead to sustainable market competitiveness.

The backwardness of innovation is partly a consequence of managers' attitude.

Figure 16: Various R+D activities are performed only by a small percentage of the responding companies



The methodology of decision making and functional policy making should be substantially improved.

(15) As for the methodology of operations, recent developments led to a situation in which our companies are not only behind the world's leading companies, but the distance is increasing - while in the same time current trends in Hungary compare favorably not only with the ex-socialist countries but with the less developed Western European countries as well. The deciding factors here are exactly innovation and education; their development will determine whether we can integrate to the global economy at a favorable level.

(16) Generally speaking, our companies' competitiveness has been positively influenced by the development of the use of informatics in business. There was a fast improvement in the country-wide information networks. They are now available for anyone and their actual utilization is also increasing, though not at a revolutionary pace. Besides further financial investments in the area, further education and training efforts would be necessary.

4. Closing conclusions

The theses described in our report hopefully illustrate why we formulated in the introduction our opinion about the competitiveness of the Hungarian enterprise sphere: we have good chances, but very important changes are necessary for a lasting success.

At the end of the research program, however, we have more questions about the competitiveness of our companies than at the beginning. Most of these questions cannot be answered within the chosen boundaries of this research. Who knows what will be the contents of the word “competitiveness” in a decade or two, in the world of global corporations, of integrations embracing whole continents, of microregions with very effective representations of their interests, and of the networks of information superhighways? Hard to answer. However, to have a chance, we at least must have a clear view about our potential: we wish to contribute to this self-knowledge with our research program and this report.

